



El Paso Festival Association Audit Report

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Internal Audit Office
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**City of El Paso
Internal Audit Office
El Paso Festival Association Audit**

EXECUTIVE SUMMARY

The Internal Audit Office has concluded its audit of the El Paso Festival Association, Inc. (EPFA). Based on the results of the audit, six (6) findings were identified to indicate internal control breakdowns within the EPFA. All six (6) findings are considered material in nature.

Listed below is a summary of the six (6) findings identified in this report:

1. There appears to be a conflict of interest between the El Paso Empowerment Zone (EPEZ) and EPFA, as there was never an arm's length relationship between the two. The EPFA was managed and controlled by the EPEZ without the City of El Paso's knowledge.
2. The EPFA did not meet its stated purpose which includes, "...To organize and operate festivals and cultural events for the purposes of stimulating economic development and community revitalization in the El Paso Empowerment Zone..."
 - During FY 2006-2007:
 - Two out of three festivals (67%) were not held within the Empowerment Zone.
 - Three festivals operated at a net loss of \$154,318.00.
 - During FY 2007-2008:
 - One out of two festivals (50%) was not held within the Empowerment Zone.
 - One out of two festivals (50%) operated at a net loss of \$9,598.00. Financial data for the second festival was not available during our review period; therefore, it was not included in our calculation.

3. There is a lack of comprehensive financial records. There were at least three sets of overlapping, unaudited financial records. Two sets of financial records were maintained by the EPEZ Finance Director and one set was maintained by the EPFA Executive Director.

Based on the lack of comprehensive financial records, an analysis of the EPFA expenses resulted in the following questionable business expenses:

- 18 out of 23 EPFA administrative expense categories (78%), totaling \$149,941.09.
 - 14 out of 22 EPFA festival expense categories (64%), totaling \$390,895.69.
4. There is a lack of a signed promissory note, contract, agreement, or sub-recipient agreement to support the \$291,514.00 accounts payable to the EPEZ. There was an accounts payable to the EPEZ listed in the two sets of EPFA financial records maintained by the EPEZ Finance Director. However, an accounts payable to the EPEZ was not listed in the EPFA financial records maintained by the EPFA Executive Director.
 5. Due to an internal control breakdown at the EPFA over the cash handling and deposit procedures, we were unable to determine if \$495,907.69 deposited for the period April 1, 2006 to March 31, 2007 consists of all of the revenue generated by the EPFA.
 - There were no written policies and procedures to safeguard cash.
 - Support documentation for deposits was not maintained:
 - 21 out of 87 deposits (24%) totaling \$102,670.06 did not have a deposit slip listing the amounts of cash and checks deposited.
 6. The EPFA managed a New Year's Festival as part of a consulting agreement between the EPFA and Union Plaza Clubs. However, as part of the agreement the EPFA contributed more in goods and services (\$16,000.00) than they received for their consulting fee (\$12,000.00) resulting in a loss to the EPFA of at least \$4,000.00. In addition, the income statement for the festival was inaccurate.

For a detailed explanation of each of the findings please refer to the appropriate finding contained in the body of this Audit Report.

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BACKGROUND

The El Paso Festival Association, Inc. was created by the El Paso Empowerment Zone to replace the Salsa for the Soul District Program. The Salsa for the Soul District Program was originally funded under Performance Measurement Systems (PERM) 3.2.5 for contract year January 1, 2005 to January 5, 2006 under the auspices of the El Paso Empowerment Zone. The program had a budget of \$436,450.00 with in-kind contributions of \$509,000.00. Three festivals were scheduled as part of this program:

- Custom Car & Chopper Festival - June 18 & 19, 2005
- Salsa Festival - September 4, 2005
- Rasquache Festival - October 29, 2005

During 2005 the El Paso Empowerment Zone created the El Paso Festival Association, Inc. which was chartered on December 2, 2005. Under Article IV of its Articles of Incorporation the purpose of the El Paso Festival Association, Inc. was to:

“Perform charitable, scientific, and educational activities within the meaning of Section 501 (c)(3) non-profit corporation under the Internal Revenue Code and Section 11.18(c) of the Texas Tax Code.”

On March 31, 2006 the Articles of Incorporation were amended to change the purposes for which the corporation was organized:

“To organize and operate festivals and cultural events for the purposes of stimulating economic development and community revitalization in the El Paso Empowerment Zone...”

Both the initial execution of the Salsa for the Soul District Program and the subsequent incorporation and operation of the El Paso Festival Association, Inc. were controlled and managed by the El Paso Empowerment Zone staff, management and board.

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AUDIT OBJECTIVES

The objectives of the audit were to conduct sufficient audit work to identify questionable business expenses incurred by the El Paso Festival Association, Inc. (EPFA), a questionable business operation of the El Paso Empowerment Zone (EPEZ). The audit was conducted at the request of the Deputy City Manager for Quality of Life Services, due to a concern where an account receivable of \$291,514.00 was identified during a Monitoring Review of the EPEZ.

AUDIT SCOPE

The scope of the audit was from the inception of the EPFA on December 2, 2005 to the present.

AUDIT METHODOLOGY

To achieve our audit objectives we conducted interviews with EPFA administration; obtained bank confirmations; performed a review of EPFA financial records; reviewed income and expense calculations; verified and recalculated financial transactions to ensure completeness and accuracy; and conducted an analysis of the internal control environment.

Authority for this audit has been granted to the City of El Paso as the funding source for HUD pass-through grant funds. These funds were provided to the El Paso Empowerment Zone, a sub-recipient, and subsequently passed-through to the El Paso Festival Association, Inc.

The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors.

FINDINGS

The findings, which follow, relate to the general internal control environment within the EPFA. These findings are considered material findings, which are those that could have a significant effect on financial statements, identify an internal control breakdown, a violation of a procedure, law, and/or regulation, which the organization is required to follow.

Finding 1

Conflict of Interest

- We performed an analysis of the EPFA and EPEZ Board of Directors and staff as of the EPFA's date of incorporation, December 2, 2005. There appears to be a conflict of interest in the following areas:
 - Three out of five EPFA board members (60%) were also functioning as EPEZ board members or staff.
 - Four out of four EPFA staff members (100%) were also EPEZ staff and were performing duties for both organizations.
- In addition, the EPFA and EPEZ were not two separate organizations as there was never an arm's length relationship. The EPFA was both managed and controlled by the EPEZ (without the City of El Paso's knowledge) as noted below:
 - EPFA was housed in the EPEZ office until March 2006.
 - EPEZ Finance Director maintained EPFA financial records from March 2006 until July 2006, and controlled the EPFA bank account until June 2006.
 - EPEZ paid EPFA expenses and salaries. An account receivable from the EPFA to the EPEZ was recorded in the EPEZ books; however, a signed agreement for the receivable could not be found.
 - EPEZ transferred \$86,811.39 to the EPFA on August 17, 2006, consisting of income generated by the Salsa for the Soul District festivals held during 2005.

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Finding 2

Purpose Not Fulfilled

The purpose of the EPFA is outlined in Article IV of the Amended Articles of Incorporation and Article III of the Amended Bylaws which state:

“1. To organize and operate festivals and cultural events for the purposes of stimulating economic development and community revitalization in the El Paso Empowerment Zone, generating funds for the purpose of providing grants to residents of the El Paso Empowerment Zone...”

An analysis of festivals held by the EPFA was performed to determine if the EPFA met the purpose for the organization. We determined whether the festivals were held in the Empowerment Zone and if they generated funds to provide grants. The result of our analysis indicates that the EPFA did not fulfill its stated purpose:

- During fiscal year 2006-2007 the EPFA held three festivals. The following was noted:

FY 2006-2007 Festival	Date	Location	In the Empowerment Zone?	Net Income / (Loss)
Cinco de Mayo Tequila (Note 1)	May 5 - 7, 2006	Ascarate Park	No	\$ (76,565.00)
Custom Car & Chopper (Note 1)	Jun. 3 - 4, 2006	Texas Ave.	Yes	\$ (82,467.00)
Salsa (Note 2)	Sep. 30 - Oct. 1, 2006	Cohen Stadium	No	\$ 4,714.00
			Net Income / (Loss)	\$ (154,318.00)

Met Purpose	#	%
Yes	1	33
No	2	67
Total	3	100

- During fiscal year 2007-2008 the EPFA held two festivals and had one more scheduled. The following was noted:

FY 2007-2008 Festival	Date	Location	In the Empowerment Zone?	Net Income / (Loss)
Cinco de Mayo Tequila (Note 1)	May 5 - 6, 2007	Ascarate Park	No	\$ (9,598.00)
Custom Car & Chopper	August 18 -19, 2007	Texas Ave.	Yes	(Note 3)
			Net Income / (Loss)	\$ (9,598.00)

Met Purpose	#	%
Yes	1	50
No	1	50
Total	2	100

Note 1 – Net income/loss figures were obtained from records compiled by the EPEZ Finance Director.
Note 2 – Net income/loss figures were obtained from records compiled by the EPFA Executive Director.
Note 3 – Festival financial data was not available before our testing was completed and could not be included in the calculation of net income/loss.

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Finding 3

Lack of Comprehensive Financial Records

There is a lack of comprehensive financial records for the EPFA. The following was noted for the financial records found:

General Ledger	Activity Starting From	Activity To	Maintained by	Accounting Software Used	# of Accounts in General Ledger	Comments
#1	3/28/2006	3/31/2006	EPEZ Finance Director	Great Plains	22	A hard copy file was recovered from the EPEZ office. The file contains the support documentation for one of two deposits made during this period. However, there is no support documentation for the remaining entries made in the general ledger. The EPFA opened their bank account with a beginning balance on 3/1/06 of \$0.00 and ending balance on 3/31/06 of \$2,552.04. Journal entries indicate that the EPEZ paid for EPFA expenses during the month of March 2006. The EPEZ Detail Inquiry Report for 2006 identifies the payments made on behalf of the EPFA during March 2006.
#2	3/1/2006	Current	EPFA Executive Director	Quickbooks	122	EPFA Executive Director stated that the books and bank account were not handed over to the EPFA until June 2006. However, financial records maintained by the EPFA begin on 3/1/06 and overlap with the records maintained by the EPEZ Finance Director. The general ledger does not contain an account recording a payable due to the EPEZ in the amount of \$291,514.00.
#3	4/3/2006	7/28/2006	EPEZ Finance Director	Great Plains	124	Hard copy files containing some support documentation were recovered from the EPEZ office but only for the period April 2006 to June 2006. There was no hard copy file for July 2006. Journal entries indicate that the EPEZ paid for EPFA expenses during the months of April through July 2006.

Note: The EPFA fiscal year was April 1 to March 31.

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Finding 3 (cont.)

We were unable to rely on any of the financial records based on the following:

- There is a minimum of three sets of records, of which none contained total EPFA activity from inception to the present and included activity periods that overlapped with one another.
- Two different accounting software packages were used.
- Each set of records contains a different number of accounts (22, 122, and 124).
- These were all unaudited financial records.

Due to a lack of comprehensive financial records, testing could not be performed to determine the validity of costs incurred by the EPFA. Therefore, an analysis was performed to determine questionable administrative and festival expense categories. The results of the analysis indicate the following questionable expenses:

- 18 out of 23 EPFA administrative expense categories (78%), totaling \$149,941.09.
- 14 out of 22 EPFA festival expense categories (64%), totaling \$390,895.69.

Finding 4

Lack of Executed Documentation

There is a lack of a signed promissory note, contract, agreement, or sub-recipient agreement to support the \$291,514.00 accounts payable to the EPEZ.

The EPFA began operations without its own cash flow, resulting in all of its expenses being paid by the EPEZ. Expenses paid by the EPEZ on behalf of the EPFA were recorded as an accounts receivable in the EPEZ's audited financial statements. An accounts payable to the EPEZ is listed in the two sets of EPFA financial records maintained by the EPEZ Finance Director, but an accounts payable to the EPEZ was not listed in the EPFA financials records maintained by the EPFA Executive Director. However, there is no evidence of a written agreement outlining the terms of the "loan" being made to the EPFA by the EPEZ.

In an effort to replenish the EPEZ money spent on EPFA expenses and to reduce the amount of the accounts receivable due from the EPFA, the EPFA applied for a \$150,000.00 Social Enterprise Loan from the EPEZ. The EPEZ Board approved the loan; however, the City denied the request for the loan based on the questionable ability for repayment by the EPFA. As a result of the City's denial, a grant agreement was drafted for a \$150,000.00 grant from the EPEZ to the EPFA. During a review of EPFA documentation provided by the EPFA Executive Director, a copy of a grant agreement for \$150,000.00 was found. However, the grant agreement was never executed as it was not signed by either the EPEZ or EPFA. Regardless, the EPEZ continued to pay for a number of EPFA expenses.

Finding 5

Cash Handling & Deposits

- Testing of the EPFA bank deposits for its fiscal year April 1, 2006 to March 31, 2007 was conducted. The results of our testing indicate the following:
 - For the period April 1, 2006 to March 31, 2007 the EPFA deposited \$495,907.69.
 - Support documentation for bank deposits is not maintained resulting in an increased risk of loss or theft as shown below:
 - 21 out of 87 deposits (24%) totaling \$102,670.06 did not have a deposit slip listing the amount of cash and checks deposited.
- There was an internal control breakdown at the EPFA for cash handling and deposit procedures to include the following:
 - There were no written cash handling and deposit procedures to safeguard cash.
 - It appears that festival cash receipts were counted and deposited by one employee.
 - Festival deposits were not verified by a second person.
 - Festival deposits were not made on a nightly basis.
 - The majority of the EPFA festival revenues were derived from cash receipts from booth rentals, gate receipts, t-shirt and beverage sales.
- Due to the internal control breakdown in the cash handling and deposit processes, we cannot provide reasonable assurance that the \$495,907.69 deposited for the period April 1, 2006 to March 31, 2007 is in fact all of the revenue generated by the EPFA.

Finding 6

New Year's Festival

The EPFA entered into a consulting agreement with three Union Plaza Clubs to manage a New Year's Festival held on December 31, 2006. A review of the consulting agreement and the income statement for the festival was performed.

The following was noted for the New Year's Festival income statement:

- The income statement provided to the Union Plaza Clubs was inaccurate.
- After reviewing and recalculating the income statement, a net loss of \$11,860.00 should have been reflected and reported.
- The EPFA paid for festival expenses on behalf of the Union Plaza Clubs. However, it is not clear whether the EPFA was paid upfront or reimbursed for the festival expenses.

The consulting agreement resulted in a loss to the EPFA of at least \$4,000.00 for managing the New Year's Festival as shown below:

Revenue Received by EPFA per Consulting Agreement:

Consulting Fee	\$12,000.00
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Additional Expenses Incurred by EPFA per Consulting Agreement:

Advertising	12,000.00	
Fireworks Display	4,000.00	<u>\$16,000.00</u> *

Loss to the EPFA	<u><u>(\$4,000.00)</u></u>
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* These expenses do not include expenses such as EPFA salaries or other management expenses.

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INHERENT LIMITATIONS

Because of the inherent limitations of internal controls, errors or irregularities may occur and not be detected. Also, projections of any evaluation of the internal control structure to future periods are subject to the risk that procedures may become inadequate due to changes in conditions, or that the degree of compliance with the procedures may deteriorate.

CONCLUSION

Based on the results of this audit, we believe that the El Paso Festival Association, Inc. (EPFA) incurred questionable business expenses during the operation of its festivals. However, a definitive amount could not be determined due to the lack of comprehensive audited financial records.

There appears to be an existence of a conflict of interest between the EPEZ and EPFA Board Members, management, and staff, which was compounded by the EPEZ having control over the EPFA's financial records, bank account, income and expenses without the knowledge of the City of El Paso's staff. Thus making oversight of the EPFA not the City of El Paso's responsibility because of the lack of openness and honesty by EPEZ management.

The lack of a strong internal control environment led to serious internal control breakdowns within the EPFA, as evidenced by the following:

- Unprofitable festivals, unprofitable consulting agreements, and holding festivals outside of the Empowerment Zone, which prevented the EPFA from fulfilling its purpose.
- The lack of supporting documentation prevented the verification of a reported Account Payable to the EPEZ and deposits for festivals held by the EPFA.
- The lack of audited and comprehensive financial records prevented the reliance on the figures contained in EPFA and EPEZ records.

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